

## Message Text

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ACTION EB-04

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TO TREASURY DEPT WASHDC PRIORITY  
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USMISSION EC BRUSSELS  
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C O N F I D E N T I A L SECTION 01 OF 03 LONDON 04661

LIMDIS GREENBACK

E.O. 11652: XGDS-1  
TAGS: EFIN. UK  
SUBJECT: H.M.TREASURY OFFICIAL ON EC MONETARY COMMITTEE,  
FINANCE COUNCIL DELIBERATIONS AND U.K. ECONOMY

REFS: (A) EC BRUSSELS 2501; (B) LONDON 1785

SUMMARY: SENIOR HM TREASURY OFFICIALS REPORT THAT  
DUISENBERG PROPOSALS ON TARGET ZONES HAVE BEEN PLACED ON  
THE BACK BURNER, WHERE THEY DESERVE TO BE. THERE IS GEN-  
ERAL AGREEMENT AMONG EC FINANCE MINISTERS ON THE NEED FOR  
A 30 TO 50 PERCENT INCREASE IN IMF QUOTAS. US WILL NOT  
BE PRESSED TO RATIFY THE OECD FINANCIAL SUPPORT FUND.  
EC'S 4TH MEDIUM-TERM ECONOMIC POLICY PROGRAM IS UNREALIS-  
TIC AND BASED ON POOR QUALITY EC SECRETARIAT WORK. CHAN.  
CELLOR HEALEY'S ATTEMPTS TO STREAMLINE EC FINANCE COUNCIL  
PROCEDURES ARE HAVING MIXED SUCCESS. BANK OF ENGLAND PRO-  
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POSALS TO PROMOTE CLOSER WORKING RELATIONSHIPS BETWEEN  
COMMERCIAL BANKS AND IMF AND IBRD. POSSIBLY THROUGH ES-  
TABLISHMENT OF A NEW FACILITY OR A NEW INSTITUTION HAVE  
NO OFFICIAL SUPPORT IN HMG; UK TREASURY HAS NOT YET TAKEN  
A POSITION ON THE IDEA NOR HAS IT BEEN BROUGHT TO THE AT-  
TENTION OF MINISTERS. IDEA MAY BE BY-PASSED BY WITTEVEEN  
SUPER-TRANCHE INITIATIVES. HM TREASURY VERY CONCERNED THAT

THE APPROPRIATE ORDER OF PRIORITIES FOR THE BENEFITS ARISING FROM NORTH SEA OIL SHOULD BE REPAYMENT OF FOREIGN DEBT. RESTRUCTURING OF INDUSTRY AND MILD REFLATION TO HELP REDUCE UNEMPLOYMENT, IN THAT ORDER. END SUMMARY.

1. A SENIOR HM TREASURY OFFICIAL WHO ATTENDS EC MONETARY COMMITTEE SESSIONS AND ACCOMPANIES CHANCELLOR HEALEY TO EC FINANCIAL COUNCIL BRIEFED FINANCIAL ATTACHES ON SUBSTANCE OF MOST RECENT DISCUSSIONS IN EC SESSIONS. SOURCE FIRST REPORTED THAT HE HAD COME FROM A LENGTHY MEETING IN TREASURY WHERE OFFICIALS WERE TRYING TO MAKE CERTAIN THAT THE FOREIGN EXCHANGE AND FINANCIAL BENEFITS OF NORTH SEA OIL WOULD BE USED TO MEET THE FOLLOWING PRIORITIES. FIRST TO REPAY FOREIGN INDEBTEDNESS: SECOND TO RESTRUCTURE BRITISH INDUSTRY: THIRD FOR MILD REFLATION AIMED AT REDUCING UNEMPLOYMENT. AT MOST, BENEFITS OF NORTH SEA OIL WILL BE EQUAL TO ONLY 5 PERCENT OF GDP. IT WOULD BE EASY TO SQUANDER THE BENEFITS. DURING DISCUSSION FINANCIAL ATTACHE CITED RECENT COMMENT BY MIDLAND BANK (COPY SENT TO ABBOTT. TREASURY) THAT THE OIL BENEFIT OF NORTH SEA COULD BE OFFSET BY A NOT ENORMOUS INCREASE -- ABOUT 1-1/2 PERCENT A YEAR -- IN THE VALUE OF NON-OIL UK IMPORTS RELATIVE TO NON-OIL EXPORTS. ACCORDING TO MIDLAND STUDY. THIS COULD HAPPEN THROUGH A CONTINUATION OF THE TREND INCREASE IN IMPORTS OF MANUFACTURES. SOURCE SAID HM TREASURY IS WELL AWARE OF THIS POSSIBILITY. TREASURY IS DOING ITS BEST TO ASSURE THAT SPENDING MINISTRIES IN HM GOVERNMENT DO NOT GET THEIR HANDS ON NORTH SEA BENEFITS TO INCREASE CONSUMPTION. CONFIDENTIAL

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2. TURNING TO EC FINANCE COUNCIL DEVELOPMENTS, SOURCE SAID CHANCELLOR HEALEY'S ATTEMPT AS CHAIRMAN TO STREAMLINE PROCEDURES WAS MEETING WITH MIXED SUCCESS. CHANCELLOR HAS PRESSED FOR MORE PRIVATE SESSIONS BETWEEN MINISTERS SUCH AS AT THE LUNCHEONS AND FOR KEEPING DOWN THE NUMBER OF OFFICIALS ACCOMPANYING MINISTERS TO ONLY ONE OR TWO. IN ADDITION, HEALEY HAS BEEN ATTEMPTING TO HAVE PRIVATE SESSIONS OF THE MINISTERS DIRECTLY BEFORE AND IMMEDIATELY AFTER THE LUNCHEONS. THIS IS CREATING DIFFICULTIES FOR SOME COUNTRIES (GERMANY AND DENMARK MENTIONED) WHICH SOMETIMES SEND TWO OR THREE MINISTERS TO THE SESSIONS AND HAS ALSO CREATED STAFFING DIFFICULTIES.

3. IN REPLY TO QUERY ABOUT DUTCH CRITICISM OF THE EC BEING EXCLUDED FROM THE MAY SUMMIT SESSIONS, SOURCE SAID HE DID NOT BELIEVE THE CRITICISM WAS AIMED DIRECTLY AT THE UK. THE UK IS WILLING TO ACCEPT EC REPRESENTATION AT THE SUMMIT IF THERE IS A CONSENSUS OF FAVOR OF THIS

VIEW AMONG EC PARTNERS. MAIN OBJECTIONS COME FROM THE

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AMEMBASSY TOKYO  
USMISSION EC BRUSSELS  
USMISSION OECD PARIS

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FRENCH. GISCARD IS ADAMANT THAT THE COMMISSION SHOULD NOT BE REPRESENTED. IN ADDITION, PRIME MINISTER CALLAGHAN WILL NEED TO MAKE CLEAR THAT AT THE SUMMIT HE IS REPRESENTING ONLY THE UK AND NOT THE EC. TO DO OTHERWISE COULD RAISE SERIOUS PROCEDURAL PROBLEMS FOR LATER SUMMITS, IF FOR EXAMPLE, A DANE OR LUXEMBOURGER SHOULD BE PRESIDENT OF THE EC COUNCIL AT THE TIME.

4. DISCUSSION OF THE COMMUNITY ECONOMIC SITUATION OPENED WITH A BRILLIAN EXPOSITION FROM ORTOLI WHO GAVE A TOUR D'HORIZON CITING THE SITUATION IN EACH MEMBER COUNTRY, CALLING INTO QUESTION WHAT FURTHER STIMULATING ACTION COULD BETAKEN IN FRANCE, ITALY. THE UK AND SMALLER EC COUNTRIES, NOTING THAT DUTCH SURPLUS IS OF A SPECIAL NATURE RELATED TO NORTH SEA GAS AND, BY IMPLICATION AT LEAST, PUTTING THE BALL IN GERMANS' COURT IN TERMS OF THE ONE MAJOR COUNTRY IN THE EC THAT COULD USEFULLY  
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TAKE FURTHER STIMULATORY MEASURES.

5. AT THIS POINT, HEALEY. RATHER THAN GIVING THE FLOOR INITIALLY TO THE GERMANS WHO WOULD HAVE COUNTERATTACKED, INSTEAD CALLED ON THE ITALIANS EXPECTING THEM TO GIVE A FORWARD-LOOKING DESCRIPTION OF THEIR DIFFICULTIES AND PROBLEMS. THE ITALIAN DELEGATE INSTEAD GAVE A LENGTHY SUMMARY OF DEVELOPMENTS IN ITALY DURING THE PAST YEAR. HEALEY INTERRUPTED ASKING IF THE SPEAKER COULD NOT GIVE SOME IDEA OF ITALY'S FUTURE POTENTIAL DIFFICULTIES. ITALIANS REPLIED THE HISTORY IS ALSO IMPORTANT AND CONTINUED FOR ANOTHER 15 MINUTES. GIVING DETAILS OF THE PAST. ACCORDING TO SOURCE, A GOOD OPPORTUNITY WAS WASTED. WHEN THE GERMANS TOOK THE FLOOR FINANCE MINISTER APEL DEFENDED WHAT THE GERMANS HAD DONE IN THE PAST RATHER THAN CONCENTRATE ON WHAT MIGHT BE DONE IN THE FUTURE. AT ONE POINT IN THE DISCUSSION, HOWEVER, APEL DID COMMENT ON THE RETIREMENT OF CENTRAL BANK GOVERNOR KLAUSEN. NOTING THE STRONG ROLE PLAYED BY THE BUNDESBANK AND SAYING THAT UNTIL THE NEW GOVERNOR HAD BEEN INSTALLED AND HIS OWN POLICY VIEWS MADE CLEAR, NOTHING COULD BE TAKEN ABSOLUTELY FOR GRANTED. SOURCE CALLED THIS INTERVENTION INCREDIBLY FRANK INASMUCH AS IT WAS GIVEN BY A FINANCE MINISTER TO HIS COLLEAGUES. SOURCE SAID UK HOPES BOTH GERMAN AND JAPANESE OFFICIAL GROWTH TARGETS WILL BE MET, BUT IS NONETHELESS SKEPTICAL OF THE OUTCOME.

6. FOURTH MEDIUM-TERM ECONOMIC POLICY PROGRAM, SETTING GOALS OF 5 PERCENT GROWTH IN REAL INCOME TO, AND FULL EMPLOYMENT BY. 1980, WAS TERMED UNREALISTIC. THE EC SECRETARIAT WORK IS CONSIDERED TO BE OF POOR QUALITY COMPARED TO THE WORK DONE BY THE OECD. WHEREAS THE COMMISSION HAS BEEN ASKED TO LOOK AT ITS PROGRAM AGAIN TO RE-THINK ITS REALISM, THE MINISTERS APPROVED THE BROAD THRUST OF THE PROGRAM TO AVOID HAVING THE COMMISSION EMBARK ON A NEW REPORT.

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7. FINANCIAL ATTACHE ASKED IF THE UK HAS AS YET DETERMINED WHEN AND HOW IT WILL LIFT EXCHANGE CONTROLS IN ORDER TO MEET THE TIMETABLE ON LIBERALIZATION OF CAPITAL MOVEMENTS SET FORTH IN ARTICLE 124 IN THE UK TREATY OF ACCESSION TO THE EC. AFTER ALL, THE UK SHOULD BE IN BALANCE OF PAYMENTS SURPLUS FROM 1978 ONWARDS. WHAT EXCUSE WILL IT GIVE IF THE TIMETABLE IS NOT MET. SOURCE REPLIED

THE UK HAS NOT YET GIVEN ANY THOUGHT TO THESE QUESTIONS.

8. THE TIMING OF THE NEXT TRIPARTITE CONFERENCE (EC GOV-  
ERNMENT MINISTERS WITH REPRESENTATIVES OF INDUSTRY AND  
LABOR) NOT FIXED. TRADE UNIONS APPEAR TO FAVOR JUNE.  
THE TUC FOR ITS PART HAS BEEN VERY RESERVED AND RESPON-  
SIBLE, MUCH MORE INTERESTED IN STOCK-TAKING THAN IN PRO-  
POSING NEW INITIATIVES.

9. SOURCE SAID THE DUISENBERG PROPOSALS ON EXCHANGE RATE  
TARGET ZONES WERE PUT ON THE BACK BURNER WHERE THEY DE-  
SERVE TO BE. EC MEMBER GOVERNMENTS ARE IN FACT NOT READY  
TO ADOPT ANYTHING THIS AMBITIOUS. BY WAY OF EXAMPLE,  
SOURCE SAID THAT IN EC CENTRAL BANK GOVERNOR'S ALTERNATE  
SESSION RECENTLY HELD IN BASLE, BANK OF ENGLAND DIRECTOR,  
KIT MCMAHON ASKED WHICH CENTRAL BANKS PRESENT WERE READY  
TO OFFER A TARGET ZONE FOR THEIR CURRENCIES. IN REPLY HE  
RECEIVED OVERWHELMING SILENCE.

10. THERE WAS CONSIDERABLE PREPARATION FOR IMF INTERIM  
COMMITTEE MEETINGS IN APRIL. ACCORDING TO SOURCE EC MIN-  
ISTERS APPEAR AGREED THAT AN IMF QUOTA INCREASE FROM 30

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TO 50 PERCENT WILL BE NECESSARY. ONE QUESTION VERY MUCH IN THEIR MINDS IS WHAT HAPPENS WHEN THE CURRENT SECOND AMENDMENTS TO THE ARTICLES BECOME OPERATIVE AND THE 45 PERCENT TEMPORARY INCREASE IN QUOTAS DECIDED AT JAMAICA IS REMOVED. SOME DISCUSSION WAS GIVEN TO FURTHER SDR CREATION. BUT ONLY ITALY STRONGLY SUPPORTED THIS. GERMANS SPOKE ABOUT THE NEED TO MAINTAIN THE QUALITY OF THE SDR. SOURCE SAID U.K. POSITIONS AT INTERIM COMMITTEE SESSION WILL NOT CONTAIN ANY SURPRISES. EC APPEARS TO BE FALLING EASILY INTO A FAIRLY GOOD COMMON POSITION.

11. SOURCE DID NOT BELIEVE THAT THE US WOULD BE PRESSED ON RATIFICATION OF THE OECD FINANCIAL SUPPORT FUND, AT LEAST AS LONG AS US GAVE THE IMPRESSION THAT IT WAS THINKING OF OTHER ALTERNATIVES TO THE SUPPORT FUND.

12. BANK OF ENGLAND'S PUBLIC SUGGESTIONS (READ INFORMAL CONFIDENTIAL

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PROPOSALS) THAT THERE SHOULD BE CLOSER COOPERATION BETWEEN COMMERCIAL BANKS AND THE IMF AND IBRD WITH THE POSSIBILITY OF A NEW FACILITY OR NEW INSTITUTION TO BACKSTOP OR UNDERWRITE PRIVATE BANKING SECTOR LENDING TO NON-OIL PRODUCING LDCS AND SOME OF THE SMALLER OECD COUNTRIES IS BEING CONSIDERED IN HM TREASURY. THE PROPOSALS ARE BASED ON A PERCEIVED NEED TO RETHINK THE IMF'S TRADITIONAL LOAN CONDITIONALITY. IT IS FELT, IN PARTICULAR, THAT CONTEMPORARY BALANCE OF PAYMENTS DIFFICULTIES ARISE PRIMARILY FROM THE INCREASES IN OIL PRICES, AND ARE NOT ALWAYS RESPONSIVE TO THE IMF'S SHORT-TERM STABILIZATION PROGRAMS. SOURCE NOTED THAT THE U.K.'S PROBLEMS WERE PROPERLY HANDLED BY THE FUND'S TRADITIONAL CONDITIONALITY, BUT THAT THE SMALLER OECD'S AND THE LDC'S MIGHT NEED MEDIUM-TERM FINANCE THAT WAS NOT PROJECT-ORIENTED AS ARE WORLD BANK LOANS AND WHICH WOULD NOT FIT UNDER NORMAL IMF LENDING CRITERIA.

13. AS YET, HMTREASURY HAS NOT TAKEN A POSITION ON THESE SUGGESTIONS NOR HAVE THE SUGGESTIONS BEEN PUT FORWARD TO MINISTERS FOR A REACTION. THE U.K. ATTACHES CONSIDERABLE IMPORTANCE TO THE WITTEVEEN SUPER-TRANCHE PROPOSALS, WHICH WOULD PROVIDE MORE HELP FOR THOSE WHO NEED IT. THE IDEA IS ATTRACTIVE TO THE GERMANS. WHO WOULD PROBABLY PREFER TO GIVE AID TO ITALY IN THIS FORM. U.K. IS NOT SURE OF THE SAUDI'S RESPONSE. HOWEVER, AS LONG AS WITTEVEEN JUDGES THE IDEA HAS SOME CHANCE OF SUCCESS. U.K. TREASURY WILL NOT PRESS THE BANK OF ENGLAND SUGGESTIONS.

14. PLEASE TREAT ABOVE AS NOFORN.

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